MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Good afternoon, the Vice-President and I welcome you to our press conference.

Russia's aggression towards Ukraine is causing enormous suffering. It is also affecting the economy, in Europe and beyond. The conflict and the associated uncertainty are weighing heavily on the confidence of businesses and consumers. Trade disruptions are leading to new shortages of materials and inputs. Surging energy and commodity prices are reducing demand and holding back production. How the economy develops will crucially depend on how the conflict evolves, on the impact of current sanctions and on possible further measures. At the same time, economic activity is still being supported by the reopening of the economy after the crisis phase of the pandemic. Inflation has increased significantly and will remain high over the coming months, mainly because of the sharp rise in energy costs. Inflation pressures have intensified across many sectors.

At today's meeting we judged that the incoming data since our last meeting reinforce our expectation that net asset purchases under our asset purchase programme (APP) should be concluded in the third quarter. Looking ahead, our monetary policy will depend on the incoming data and our evolving assessment of the outlook. In the current conditions of high uncertainty, we will maintain optionality, gradualism and flexibility in the conduct of monetary policy. The Governing Council will take whatever action is needed to fulfil the ECB's mandate to pursue price stability and to contribute to safeguarding financial stability.

I will now outline in more detail how we see the economy and inflation developing, and will then explain our assessment of financial and monetary conditions.

Economic activity

The euro area economy grew by 0.3 per cent in the final quarter of 2021. It is estimated that growth remained weak during the first quarter of 2022, largely owing to pandemic-related restrictions.

Several factors point to slow growth also in the period ahead. The war is already weighing on the confidence of businesses and consumers, including through the uncertainty it brings. With energy and commodity prices rising sharply, households are facing a higher cost of living and firms are confronted with higher production costs. The war has created new bottlenecks, while a new set of pandemic measures in Asia is contributing to supply chain difficulties. Some sectors face growing difficulties in sourcing their inputs, which is disrupting production. However, there are also offsetting factors underpinning the ongoing recovery, such as compensatory fiscal measures and the possibility for households to draw on savings they accumulated during the pandemic. Moreover, the reopening of those sectors most affected by the pandemic and a strong labour market with more people in jobs will continue to support incomes and spending.

Fiscal and monetary policy support remains critical, especially in this difficult geopolitical situation. In addition, the successful implementation of the investment and reform plans under the Next Generation EU programme will accelerate the energy and green transitions. This should help enhance long-term growth and resilience in the euro area.

Inflation

Inflation increased to 7.5 per cent in March, from 5.9 per cent in February. Energy prices were driven higher after the outbreak of the war and now stand 45 per cent above their level one year ago. They continue to be the main reason for the high rate of inflation. Market-based indicators suggest that energy prices will stay high in the near term but will then moderate to some extent. Food prices have also increased sharply. This is due to elevated transportation and production costs, notably the higher price of fertilisers, which are in part related to the war in Ukraine.

Price rises have become more widespread. Energy costs are pushing up prices across many sectors. Supply bottlenecks and the normalisation of demand as the economy reopens also continue to put upward pressure on prices. Measures of underlying inflation have risen to levels above two per cent in recent months. It is uncertain how persistent the rise in these indicators will be, given the role of temporary pandemic-related factors and the indirect effects of higher energy prices.

The labour market continues to improve, with unemployment having fallen to a historical low of 6.8 per cent in February. Job postings across many sectors still signal robust demand for labour, yet wage growth remains muted overall. Over time the return of the economy to full capacity should support faster growth in wages. While various measures of longer-term inflation expectations derived from financial markets and from expert surveys largely stand at around two per cent, initial signs of above-target revisions in those measures warrant close monitoring.

Risk assessment

The downside risks to the growth outlook have increased substantially as a result of the war in Ukraine. While risks relating to the pandemic have declined, the war may have an even stronger effect on economic sentiment and could further worsen supply-side constraints. Persistently high energy costs, together with a loss of confidence, could drag down demand and restrain consumption and investment more than expected.

The upside risks surrounding the inflation outlook have also intensified, especially in the near term. The risks to the medium-term inflation outlook include above-target moves in inflation expectations, higher than anticipated wage rises and a durable worsening of supply-side conditions. However, if demand were to weaken over the medium term, it would lower pressure on prices.

Financial and monetary conditions

Financial markets have been highly volatile since the war began and financial sanctions were imposed. Market interest rates have increased in response to the changing outlook for monetary policy, the macroeconomic environment and inflation dynamics. Bank funding costs have continued to increase. At the same time, so far there have been no severe strains in money markets, nor liquidity shortages in the euro area banking system.

Although remaining at low levels, bank lending rates for firms and households have started to reflect the increase in market interest rates. Lending to households is holding up, especially for house purchases. Lending flows to firms have stabilised.

Our most recent bank lending survey reports that credit standards for loans to firms and for housing loans tightened overall in the first quarter of the year, as lenders are becoming more concerned about the risks facing their customers in an uncertain environment. Credit standards are expected to tighten further in the coming months, as banks factor in the adverse economic impact of Russia’s aggression towards Ukraine and higher energy prices.

Conclusion

Summing up, the war in Ukraine is severely affecting the euro area economy and has significantly increased uncertainty. The impact of the war on the economy will depend on how the conflict evolves, on the effect of current sanctions and on possible further measures. Inflation has increased significantly and will remain high over the coming months, mainly because of the sharp rise in energy costs. We are very attentive to the current uncertainties and are closely monitoring the incoming data in relation to their implications for the medium-term inflation outlook. The calibration of our policies will remain data-dependent and reflect our evolving assessment of the outlook. We stand ready to adjust all of our instruments within our mandate, incorporating flexibility if warranted, to ensure that inflation stabilises at our two per cent target over the medium term.

We are now ready to take your questions.

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I have two questions. The first one: could you give us a bit of a flavour for the discussion? Did some of your colleagues call for a more definite end date for the APP, and what was the clincher argument for keeping your formulation despite sharply higher inflation?

The second question is about interest rates and markets now pricing two rate hikes this year, and maybe as much as eight hikes by the end of 2023. Are you comfortable with these expectations? Are these expectations consistent with your definition of gradual?

On your first question I would call your attention to a particular sentence in the monetary policy statement (MPS), which reflects the evolution of the Governing Council assessment of the current situation five weeks after the last monetary policy Governing Council meeting that we had, which is a very short interval as opposed to other periods. It is the sentence that begins the second paragraph of the MPS, where we say: “At today's meeting we judged that the incoming data since our last meeting reinforce our expectation that net asset purchases under our Asset Purchase Programme (APP) should be concluded in the third quarter”. So there is a much stronger affirmation of our assessment of the data, which, as you rightly pointed out, had indeed changed since five weeks ago. Now, obviously, this meeting was not a projection exercise. It was an interim Governing Council monetary policy meeting, and we affirmed the net asset purchases' very likely conclusion in the third quarter, without being more specific, but being open-minded as to when in the quarter that is. It could be early; it could be late. The third quarter has three months, and I think the determination around the Governing Council table was to take stock of the projection exercise at the next monetary policy meeting to determine exactly the timing of such conclusion of the net asset purchases under the APP.

On your second question about how many interest rate hikes are projected by markets, let me tell you that we are sticking to our sequence, and this is very much what we did on the occasion of this Governing Council meeting. The sequence that we have adhered to, that we have agreed, is to complete net asset purchases first, and some time after that decide interest rate hike and subsequent hikes. I remember last time around on the occasion of the last monetary policy press conference, I was asked specifically what was meant by the “some time after”. I repeat what I said at the time. “Some time after” is intended to serve our determination to have both optionality, gradualism and flexibility, which means that this “some time after” can be anywhere between a week to several months. That stands and remains true. So we will deal with interest rates when we get there.

Let me ask you about the potential effect of an oil and gas embargo on inflation and the economic outlook. Have you been discussing that? Is that something which you think is a realistic scenario?

My second question would be on how concerned you are about the tightening of financial conditions, so the lending channel. We have also seen yields on the rise for the corporate space and for sovereigns. Is that something you are concerned about?

On your first question concerning the potential boycott of oil and gas – and I'm assuming that you are referring to oil and gas out of Russia, and the initiative of the boycott being either one party or the other, the supplier or the purchaser. Let me just, first of all, state that this Russian war against Ukraine is not just causing economic problems; it is causing a huge humanitarian crisis, massive economic damages, and cost and risks way beyond Europe. I've noted the joint statement by the presidents of international institutions [President Biden and President von der Leyen] to support that we all focus also on the food crisis that is going to be hitting low-income countries and other people than the Europeans. So let's put things in perspective first.

Of course, on the oil and gas front, an abrupt boycott would have significant impact. Staff monitors that very carefully. Any such risk, obviously, reinforces the determination of the Europeans to move towards cleaner energy, to move to non-fossil fuel in general, and to reduce dependency vis-à-vis Russia. But have we actually factored in exactly the net amount, the trade-off resulting from any such boycott? No. We simply know that, obviously, some countries within the euro area will be more affected than others, and we also note that the Europeans together under the leadership of the Commission are looking at ways to adopt joint approaches, joint policies, joint purchases. This certainly is, together with moving to a different energy mix, the right approach to take.

The second part of your question dealt with the tightening of rates. I have commented on the bank lending survey, which indicates that there is and there was during the first quarter a certain tightening by a larger number of banks answering the surveys. All that being said, the volume of loans to households in particular still stands quite strongly. Lending to consumers – consumption loans – have increased. Corporate lending has stabilised for the moment. So even if there is tightening, particularly concerning the terms and conditions of those lending arrangements, in terms of both rate and volume